

A Literature Review of Islamic Transactions Profit

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Abstract

This paper presents views on profit from Islamic perspective. The profit is one of the aims of the transaction such as loan, hire-purchase and purchase. However, the determination of the profit rate in Islam has boundaries. There are three main point has been discussed in this paper such as profit maximization in Islam, profit rate which prohibited in Islam and the determination of the profit. This paper reviews the way to acquire profit that follows Shariah compliance.

Key words: Shariah compliance, profit maximization, profit rate.

1.0 Introduction

Islamic economic system has divided into two type of financing which is loan financing and equity financing (A. H., Nur Fadhlina, 2013). Both types aim to earn profit. Profit through trading is accepted in Islamic economic system as economic activities and participation in trading have spiritual dimension in Islam. However, Islam has its own instruction in conducting trading. Besides that, the trading is bounded by the rules that Allah s.w.t had set.

That rules refer to Shariah law. Shariah is defined as the Islamic law that involves aspects of regulation and controls the relationships between human beings and its creator (Allah s.w.t) and human relationships that are producing good and rejecting any harm that comes from human beings (A. H., Nur Fadhlina, 2013). According to Sudin Haron and Wan Nursofiza, W. A. (2009), Shariah law must refer to the main source that is al-Quran, hadith, ijma and qiyas. Therefore, this study is conducted to address specifically about the profit in Islamic perspective. The main issues are discussed in this paper is profit maximization in Islam, profit rate which prohibited in Islam and the determination of the profit in Islam.

2.0 Literature Review

2.1 Islamic Perspective on Profit Maximization

This paper studies by Abbas J. Ali et al, (2012) starts with the statement on how religion and ethics are play an important role in conduct and priorities in trading. The authors discuss the concept in the context of Islamic ethics. Ethics role in the market place as the boundaries for accepted conduct and preventing fraud, corruption and questionable behavior. For example, widely an issue happen in economic system is from interest to monopoly and from pricing to profit margin.

In addition, there are four foundations of Islamic ethics stated by Ali, A. (2011). First foundation is *ihsan* which is implies goodness and mercy in interaction and behavior whether at a personal or an organization level. Second, relationship with others is stated by Prophet Mohamed which is *Al-Din Al-maamala* (religion is found in the way of dealing with other people). That means, judging whether any action or conduct is right or wrong based on its benefit to people and society. The third foundation is equity which is important in the market place to ensure that social welfare strengthened, and fairness is not overlooked due to any prejudice. The last one is responsibility which is strengthens market trust and commitment to business contract.

Besides that, Abbas J. Ali et al. (2012) also discuss about the profit earning in Islamic teaching. Profit maximization leads to unfair trading practice. Therefore, it will not give benefit to *ummah*. This situation happened because of many countries already exposed to global capitalism system since during their collage studies and surrounding. So, they attend accept uncritically the premise of profit maximization. However, from the Islamic ethics perspective, this condition should never be because profit maximization is not only goal in Islam. Besides that, profit maximization contradicts to the logic of *ihsan*. Based on the scholars' agreement, profit is acts as the essential means for to achieve the pleasure of Allah as well as *al-falah* in this world and hereafter. From Abbas J. Ali, et al. (2012), it shows that, profit maximization can cause exploitation, obstruction of market function and mischief and directly will affect the welfare of community.

2.2 Profit Maximization: an Islamic Perspective

There are some questions with unanswered about the profit maximization. For example, what is the meaning of profit maximization? What profit maximization is relative to? It is relative to the highest return that one receives at any given market. According to Salim-Ur-Rahman and Najeeb Zada (2014) are attempted to discuss about profit maximization. The profit maximization theory of the firm is from the theory of economics for a long time. It used as the main thrust for the firm's production. From this theory, firm maximize their profit through a simple formula. However, simple formula instrument is not in line with structure of the market. This is because, the simple interest considered the fixed profit rate though the structure of the market changed.

Authors in the article also stated about the profit maximization in al-Quran and hadith. Many verses in al-Quran mention about the profit which is profit are justice in al-Quran. High profit earns from trading mean the trades deserve to be happy and congratulated for this. In this article, it clear from al-Quran and hadith that profit is the essential and one of the important elements of economic activities. Even Islam puts no ban on earning profit, rather encourages it and fixes no limit for it. However, society must avoid dealing in what is prohibited, avoid cheating and gain Allah's blessing by being helpful and generous to *ummah*.

2.3 Parallelism between Interest Rate and Profit Rate: Comparison of Islamic Banking and Conventional Banking

This article by Ahmet, S. et. al. (2012) stated some issue and tries to clarify doubts about Islamic finance. The specific issues that discuss in this article are about to shows that the interest rate used by conventional finance parallel to profit rate used by Islamic finance. In Islamic finance, interest is prohibited. Islam encourages the making profit but forbids the changing of interest. Al-Quran says that "But Allah has permitted and forbidden usury..." (2:275). Besides, Islam also prohibited any uncertainty. For example, the term and the conditions of the risk are no clearly understood by all parties for financial transaction is not allowed.

This article mentioned about the latest crisis happened to the conventional finance system has make Islamic finance system very popular and used as alternative of conventional finance. Besides, both Muslim and non-Muslim countries start to prefer Islamic financial institutions rather than conventional institutions. Because of the crisis, this paper makes comparison between interest rate and profit rate by used empirical data. From the average rate between interest rate and profit rate it's showed that Islamic bank return and conventional banks' interest rate are parallel. However, the authors said that the explanations about the parallelism between profit rate and interest rate are not convincing people about Islamic finance.

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The authors also clearly explain that people who have doubts about Islamic finance could not be persuaded by comparison between interest rate and profit rate because to them Islamic finance is just another name for interest-based system. Some Islamic scholars and jurists say that since Islamic banks is subset to conventional banks, so it normal interest rates has similarity to profit rates, otherwise Islamic finance do not have chance to survive in this economical system. Hence, the parallel value of interest rate and profit has showed that there are no differences between conventional and Islamic finance in payment. However, the determinations of rate also need to focus in this study to make sure the rate used in Islamic finance is follow the shariah law. This is because, the goal of the Islamic finance not only to maximize the profit but also need to complaint toward shariah.

2.4 Influence of Interest Rates in Islamic Banking in Malaysia

The article by Anuar Sabaan and Sanep Ahmad (2013) had also discuss about the Islamic banking system has influenced and guided by the interest rate, especially in determination of profit rate and cost of financing. Malaysia has a dual banking which is conventional banking and Islamic banking system that makes our banking system is quite unique. The development of dual baking system in Malaysia is largely supported by the implementation of BNM's (Bank Negara Malaysia) policy, especially in terms of monetary policy. Since November 1995 until now, BNM has changed its mid-term monetary strategy from controlling the aggregate monetary policy to control the base lending rate (BLR). BLR is control by three-month intervention and the statutory reserve requirement (SRR). However, in April 2004, BNM introduced a new framework of interest rates which is known as overnight policy rate (OPR) a key indicator of monetary policy. OPR is serves as fundamentals of monetary policy and as a target of BNM daily liquidity operations. Changes in the OPR led to a change in the primary reference rate in determining other market interest rates. Therefore, it is expected that loans in the dual banking system are also affected by any changes in the country's monetary policy. According to BNM's annual report in 2010, from May 2008 until December 2010, it showed that base financing rate (BFR) is used by Islamic banks moving almost the same as the BLR of conventional banks.

The issue or problems the authors stated in this study is about the interest rates that BNM has adopted as monetary policy tool that affects the determination of financing rates or returns in Islamic banking system. So, the authors produce proof by empirical test on OPR, BLR, BFR, deposit interest rates of conventional banking and Islamic banking deposit rate of return. Analysis is done by using the test Granger cause reasons for short, Johansen cointegration test for long-term and Vector Auto-regression (VAR). The finding by Anuar Sabaan and Sanep Ahmad (2013) had shown that there is a relationship between the rate of return on Islamic banking deposits and the interest rates on conventional bank savings deposits. Thus, OPR rate affects the rate of return on Islamic banking deposits even though the Islamic banking system bans usury (*riba*). Because of interest rates affect the Islamic banking system, Islamic banks need to take the initiative to use other alternatives in determining the rate of financing and the rate of return.

2.5 Islamic Norms, the Excel Formula and Home Financing Model

An alternative process on determining the return on capital or profit and Islamic financing is discussed by Zubair Hassan (2012). Based on this article, there are two important things they needed to consider in Islamic financing. First, they need to avoid any contract that have existence element of *riba* (interest). For example, charge “interest on interest” is one of the servicing a loan should be avoided, because it seems unfair to the borrower. Second, the ownership of the property must divide into same ratio as the payment compared to the total charge has, at any point in time. Any Islamic financing model must meet this requirement. This is because both rules follow the al-Quran and fall under Islamic notion of justice. So, before contract is validated and signed, both rules must to require in Islamic financing. Besides that, the issues found in this article not focus to determining a rate of returning but rate plays in loan amortization and the consequences that follow from the process.

The author also makes demonstration of the current model used in the Islamic financing which is Excel formula. This formula clearly implies compounding of interest income. This is because excel formula is construct based on standard compound interest formula. Based on Zubair Hassan (2012), compounding formula clearly show that interest is charged on interest all along. Therefore, Excel formula also has element of *riba*. Hence, the author constructs an alternative formula or process in determination of the profit or return on capital, namely ZDBM model. Payment process in this model is give benefit in both parties. This shows from the empirical test. The author tests both model which is Excel formula and ZDBM model by using same data and same the rate of return. It shows that, the ZDBM model is cheaper for the customer without any reduction in the profit margin. Besides that, the ZDBM model is more efficient, the ownership of property passes faster to customer and it does not harm the bank any way. The ownership transfer is relevant to the reduction of the capital because in the article illustration, halfway down the time scale 50% ownership passes to the customer as compare to 40% under presently model. The author also could not find anything in Islam opposing this method of calculation if the parties agree.

3.0 Conclusion

Islamic transactions are widely used nowadays whether by Muslim or non-Muslim. So, people need to make sure the Islamic financing is Shariah compliance. Besides, Islam also emphasizes on the welfare and relationship between ummah. From the previous study in Islamic economic system, it shows that profit is one of the reasons for the transactions. So, Islam generally approves profit gains and lawful earnings which are do not lead any misconduct. Even profit is allowed in Islam, but there are issues that the scholars and the community have doubts.

The issue is when the interest rate is parallel to the profit rate. Besides that, determinations of the profit rate also lead to the element of *riba* make overall Islamic financing is non-compliant toward Shariah. In addition, financing process in Islamic economy system also same as the compounding interest formula. This is clearly that the process or the formula used in Islamic finance is same as conventional finance. While interest is prohibited in any Islamic economic activity because it prevented fair distribution of wealth between investors and prevent both parties to get benefit.

Thus, Islamic financing system need for further improvement to make sure it complaint toward Shariah. The instrument and parameter that used in the determination of profit rate must be clear. Besides that, before the contract, both parties must agree willingness the contract. This is to make sure there are no problems in ummah. To protect the all transaction in the digital world, we need the takaful protection (Ghazali, P.L., et. al., 2012a, 2012b, 2015, 2017 and 2019). Risk transfer is the one protection of Islamic transactions profit in IR 4.0 (Azhar, N.N.Z.B.A et. al., 2012).

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